

# **Consensus Revenue Agreement Final Report January 14, 2004**

## **Economic and Revenue Forecasts Fiscal Years 2004 and 2005**



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## **Executive Summary**

### **January 14, 2004**

#### **Revenue Review and Outlook**

- The year-end total for Fiscal Year (FY) 2003 GF-GP revenue on a Consensus basis was \$7,957.7 million. Compared on the same basis as the October Consensus estimates, the final GF-GP revenues were \$49.0 million above the October estimate. FY 2003 year-end School Aid Fund (SAF) revenue totaled \$10,714.7 million. On a comparable basis, SAF revenues exceeded the October forecast by \$53.3 million.
- FY 2004 GF-GP revenue is projected to decline 1.3 percent to \$7,857.5 million. On a comparable basis, this estimate is unchanged from October. SAF revenue is expected to fall 1.2 percent to \$10,584.3 million. On a comparable basis, this total is also unchanged from October.
- FY 2005 GF-GP revenue is projected to decline 0.4 percent to \$7,822.8 million; SAF revenue is projected to increase 3.9 percent to \$10,998.5 million.

#### **2004 and 2005 U.S. Economic Outlook**

- Real Gross Domestic Product (GDP) growth is forecast to average 4.6 percent in 2004 and 3.7 percent in 2005, up from 3.1 percent real GDP growth in 2003. Improvement in growth is expected to be fueled by greater business investment, including increases in inventories. Tax incentives that expire in 2004 for new investment in equipment and higher corporate profits will be the catalysts for increased business investment.
- Interest rates will increase over the forecast horizon, but remain historically low. Federal government spending will not grow as fast as in the past couple of years, while state and local government spending will remain weak. A falling dollar will improve the U.S. trade position by making net exports less of a drag on domestic economic growth.
- The U.S. unemployment rate is forecast to average 5.6 percent and 5.3 percent in 2004 and 2005, respectively. Continued growth in the job market will be the key for sustained growth for the U.S. economy. Wage and salary employment increased in the last five months of 2003, reversing the predominant trend of job losses since March 2001. If the labor market does not turn around as forecast, the national economy and Michigan's economy could grow slower than anticipated.
- Light vehicle sales are forecast to be 16.8 million units in 2004 and 16.9 million units in 2005, up slightly over the past two years.
- Consumer price inflation is forecast to be moderate, averaging 1.9 percent in 2004 and 2.5 percent in 2005.

## **2004 and 2005 Michigan Economic Outlook**

- After three straight years of decline, Michigan wage and salary employment is forecast to grow modestly over the forecast horizon. In 2004, employment is projected to rise slightly by 0.5 percent, followed by growth of 1.8 percent in 2005.
- The Michigan unemployment rate is forecast to increase to 7.2 percent for 2004 as a whole, though the rate will fall gradually throughout the year. In 2005, the Michigan unemployment rate is forecast to decline to 6.4 percent.
- Economic activity in Michigan will lag behind the national economy, due to slower employment growth. After three years of declining or flat growth, wage and salary income will post moderate gains in 2004 and 2005. In 2004 and 2005, wages and salaries are forecast to rise 2.9 percent and 4.5 percent, respectively. Personal income growth will post moderate increases throughout the forecast horizon with a 4.5 percent rise in 2004 and 5.9 percent growth in 2005.
- In FY 2004 and FY 2005, Michigan wage and salary income is expected to grow 2.4 percent and 4.6 percent. Disposable income is expected to rise 5.1 percent both in FY 2004 and FY 2005.

## **Forecast Risks**

- The economic outlook appears more positive but uncertainty remains. While the U.S. labor market is starting to firm, there are questions over whether businesses feel confident enough to create enough jobs to lower unemployment. In Michigan particularly, employment gains continue to remain elusive. Job growth remains a key component in the expected economic gains during the next two years.
- While forecasts of very strong economic growth in the coming two years are not uncommon, the economy may not live up to such high expectations. If a substantial-enough number of consumers and businesses respond to unrealized economic expectations by decreasing spending, investment, etc., then the economic recovery may be slower than anticipated.
- While light vehicle sales are forecast to be above the levels of the past two years and the import share is slightly falling, the Michigan economy may not receive an anticipated bounce due to transplant vehicles. If Big Three market share declines steeply due to transplant vehicles, Michigan economic growth would be lower than estimated.
- A rapidly falling dollar, while helping the manufacturing sector and exports, could also spur inflation and lead to instability for U.S. financial markets.

# ECONOMIC REVIEW AND OUTLOOK

January 14, 2004

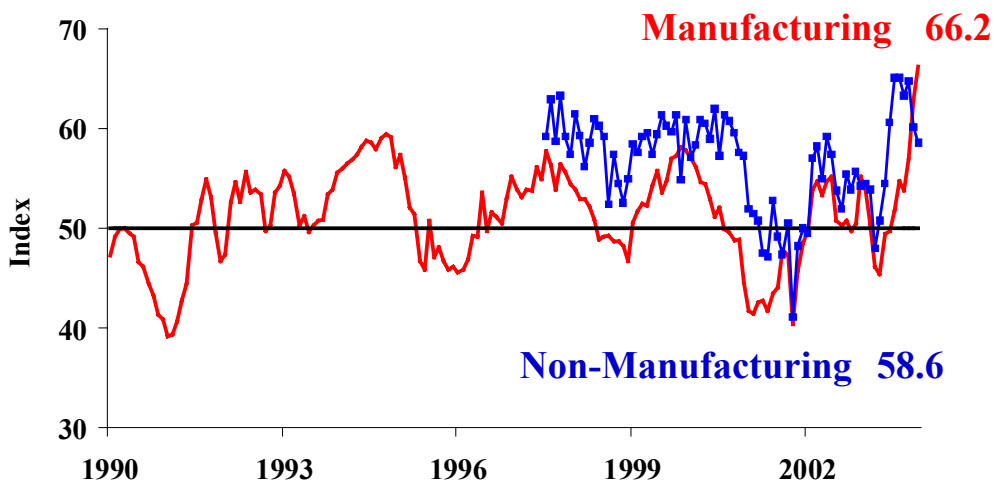
## Current U.S. Economic Situation

### Summary

It has been slightly over two years since the 2001 recession ended. Since November 2001, the U.S. economy has grown in every quarter. Real GDP grew at an 8.2 percent annual rate in the third quarter of 2003, the highest rate in nearly 20 years. Since the end of the recession, employment has stumbled but is starting to show signs of a recovery. Wage and salary employment has increased in each of the past five months. However, employment is still nearly 2.4 million jobs below the February 2001 peak. Employment growth will be the key to a sustained recovery and stronger growth.

Historically low interest rates and moderate inflation have helped consumer spending remain strong during the difficult labor market. After recently posting strong gains, consumer sentiment dropped slightly in December. Durable goods orders have been improving. The Institute for Supply Management manufacturing index has signaled a growing manufacturing sector in 18 of the 25 months since November 2001. The non-manufacturing index has indicated a growing services sector in 23 of the past 25 months.

### ISM Indices Signal Growth in Manufacturing and Services



Source: Institute for Supply Management.

While economic conditions are favorable for continued growth, the lack of job creation is worrisome. U.S. wage and salary employment has fallen 0.8 million since the end of the 2001 recession. Manufacturing employment has fallen by 1.3 million jobs, accounting for more than the total decline.

Since U.S. employment peaked in February 2001, total employment has fallen by 2.4 million jobs with manufacturing employment declines accounting for over 100 percent of the total employment decline. At this point in the early 1990s recovery, U.S. employment had regained all of the recession job losses.

Atypically strong vehicle and home sales during the 2001 recession muted the downturn. Incentives from automakers made vehicle purchases attractive while low mortgage rates helped fuel a home building boom. At the same time, strong sales through the recession imply little to no pent-up demand. Thus, even though vehicle and home sales have remained strong, they will provide less of a post-recession bounce than in previous recoveries, especially if interest rates begin to rise significantly.

While light vehicle sales have remained strong, Big Three auto companies have been under pressure. As reported by the *Detroit News*, the 2003 market share of the Big Three (General Motors, Ford, and Daimler Chrysler) declined to an all-time low of 60.3 percent.

#### Major Economic Indicators

While somewhat mixed, several major U.S. economic indicators point to continued growth moving forward.

- The Institute for Supply Management's (ISM) manufacturing index has clearly signaled a growing manufacturing sector for six straight months. The ISM non-manufacturing index indicated strong services sector growth for the ninth consecutive month.
- New durable goods orders have trended upward since May. However, durable goods orders were down in November after a stronger than expected October. Compared to a year ago, durable goods orders are increasing (three-month trailing average). Capacity utilization remains near a 20 year low. Equipment investment skyrocketed in the third quarter of 2003, after a modest gain in the second quarter.
- Retail sales have risen five of the past six months. Compared to November a year ago, retail sales were up about 6.9 percent. Consumer sentiment has increased since September. However, buying plans for durable goods, homes, and vehicles weakened in December. The ABC News consumer comfort index, which measures consumers' attitude toward current economic conditions, has been slightly more positive in recent months. However, the index reading for all of 2003 was at its lowest annual average reading since 1994.
- The Conference Board's index of leading economic indicators has increased every month since April.

## Major Economic Influences

There are many signals pointing to economic growth for the nation. Interest rates continue to remain around historic lows and the Federal Reserve has indicated it will keep short-term rates low for the foreseeable future. The target federal funds rate now stands at 1.0 percent, its lowest level since the 1950s. While mortgage refinancing has slowed, new home building continues to support near term economic growth. Enacted federal tax cuts will also help support economic growth in the near term. Productivity growth will also help support future economic growth.

In order to strengthen the current economic recovery, firms must accelerate their investment. Increasingly obsolete equipment, lean inventories, and investment tax breaks that expire at the end of 2004 will help spur growth. On the other hand, continued uncertainty and substantial excess capacity will constrain investment and hiring. Capacity utilization remains near a 20-year low. Many firms have remained reluctant to bolster investment spending and (re)build inventories. Firms continue to seek more productivity gains rather than increase their workforce.

## Employment

### *Current Employment Situation*

The U.S. labor market has remained exceptionally weak two years after the end of the 2001 recession. While U.S. employment has risen over the past five months, the amount of increase has been low. Wage and salary employment rose by only 1,000 jobs in December. Compared to a year ago, employment is down 74,000. U.S. manufacturing employment, which has fallen 41 straight months, has declined by 516,000 jobs since December 2002. Rapid productivity gains have allowed firms to reduce payroll employment even as they continue to increase output. Since the February 2001 employment peak, U.S. wage and salary employment has declined by 2.4 million jobs. Over three-quarters of a million of those jobs have been lost since November 2001, when the 2001 recession officially ended. The preliminary U.S. unemployment rate for 2003 is 6.0 percent, the highest unemployment rate since 1994.

U.S. employment indicators are mixed. Taken as a whole, they indicate that U.S. employment will begin rising but suggest that growth will be sluggish. Recent indicators suggest that employers are laying off fewer workers but still remain hesitant to hire additional workers:

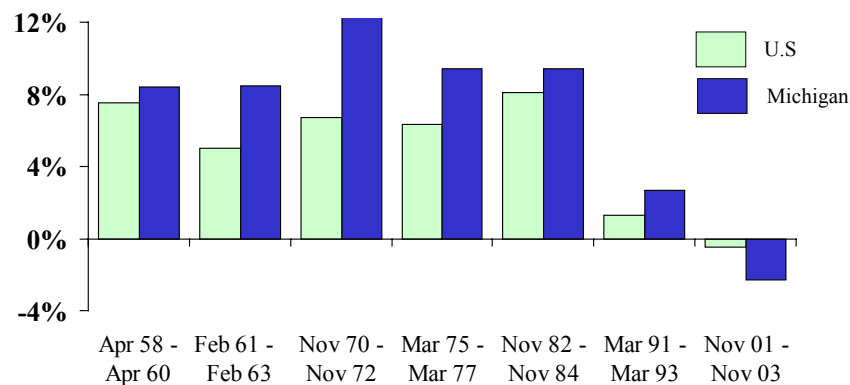
- Compared to early May, initial unemployment claims have fallen from about 450,000 to around 350,000. Weekly initial unemployment claims have been under the 400,000 mark since October.
- The four-week average of initial claims was at 350,250 on January 3, 2004, the lowest since the beginning of the 2001 recession.



- The Institute for Supply Management's (ISM) manufacturing employment index component has been rising the past few months and has shown expansion the past two months. The non-manufacturing ISM employment index has signaled expansion the past three months, after a slight contraction in September.
- Weekly hours worked, a leading indicator for employment, decreased in December after rising in November.

The lack of employment growth is shown by the following graph. In past recoveries, employment growth has increased after the recession was declared over. Even in the “jobless recovery” in the nineties, employment growth was positive two years later. Michigan has historically fared better during recoveries than the nation, but is lagging the nation two years after the 2001 recession ended.

### Employment Still Down Two Years After Recession Ended



Source: U.S. Department of Labor, Bureau of Labor Statistics. (Not Seasonally Adjusted Data)  
House Fiscal Agency Compilation.

### Vehicle Sales and Production

Substantial incentives and low interest rates, along with new federal depreciation and expensing provisions, have helped vehicle sales remain at strong levels. Through November, light vehicle sales averaged 16.5 million units and thus 2003 will mark the fifth straight year in which light vehicle sales will have exceeded 16.0 million units. However, imports and transplants continue to increase their market share with the traditional Big Three market share falling to a record low in 2003.

Averaged over the past three months ending in November 2003, U.S. vehicle production has increased 0.9 percent while Michigan vehicle production is down 0.7 percent. Michigan vehicle production for calendar year 2003 is estimated to be below calendar year 2002 levels.

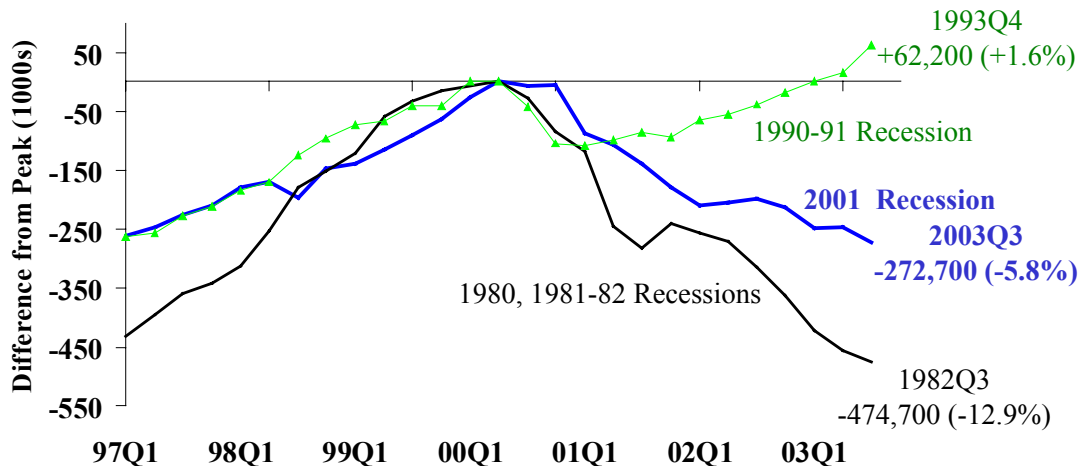
## Current Michigan Economic Conditions

### Employment

Michigan employment has fared considerably worse than overall U.S. employment. From Michigan's employment peak in the second quarter of 2000 to the third quarter of 2003, Michigan has lost 272,700 jobs, a 5.8 percent decline. In contrast, national employment has declined only 2.0 percent from its first quarter 2001 employment peak. By this time in the 1990-1991 recession experience, Michigan employment had actually *risen* above its pre-recession peak.

Michigan manufacturing has borne the brunt of the decline. Since June 2000, Michigan manufacturing employment has fallen by 185,000 jobs. Michigan has lost one out of every five manufacturing jobs it had at the state's employment peak (20.4 percent).

### **Michigan Employment Down Sharply**



Source: Research Seminar in Quantitative Economics and Bureau of Labor Statistics.

### Unemployment Rate

In November, Michigan's unemployment rate fell to 7.0 percent, down from 7.6 percent in October. October's rate was the highest in over 10 years. However, the drop in the unemployment rate was due to a smaller labor force and not an increase in employment. The state's unemployment rate is up 0.9 percentage points from a year ago and substantially above its lows during the expansion of the 1990s of around 3.0 percent. However, the 7.0 percent reading is lower than any monthly reading during the 1990-1991 recession.

### Personal Income

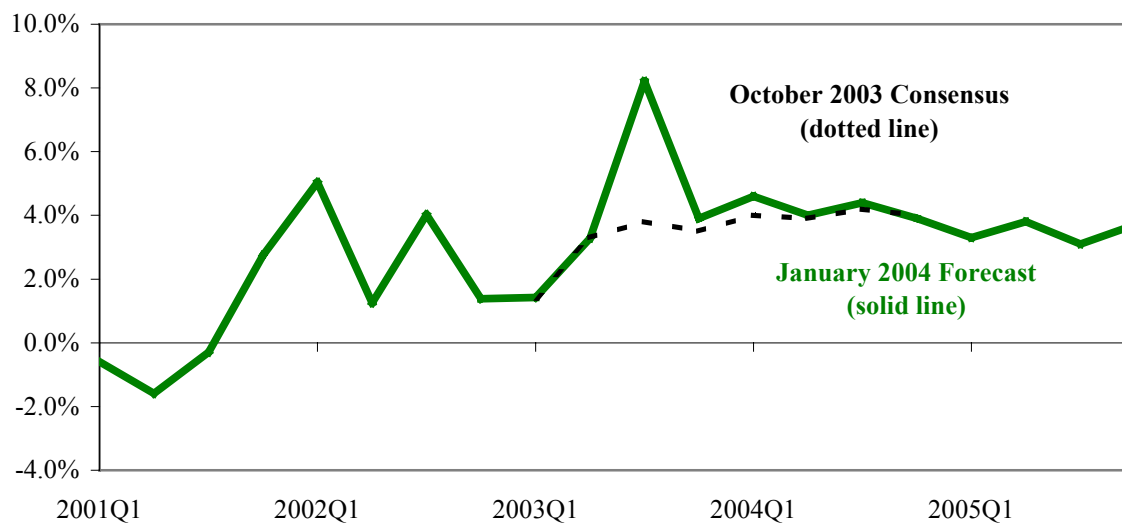
Wages and salaries growth has slowed from a 3.1 percent year-over-year increase in the first quarter of 2003 to an estimated 0.5 percent decrease in the third quarter. Following wages and salaries, overall personal income growth slowed from a 3.9 percent growth in the first quarter to a 1.7 percent growth in the third quarter.

## **2004 and 2005 U.S. Economic Outlook**

### **Summary**

Real GDP is forecast to grow 3.1 percent in 2003, after a strong second half of the year, with actual growth of 8.2 percent in the third quarter and an estimated 3.9 percent growth in the fourth quarter. Real GDP is expected to accelerate with 4.6 percent growth in 2004 and then slow slightly to 3.7 percent growth in 2005.

### **Real GDP Forecast Comparisons**



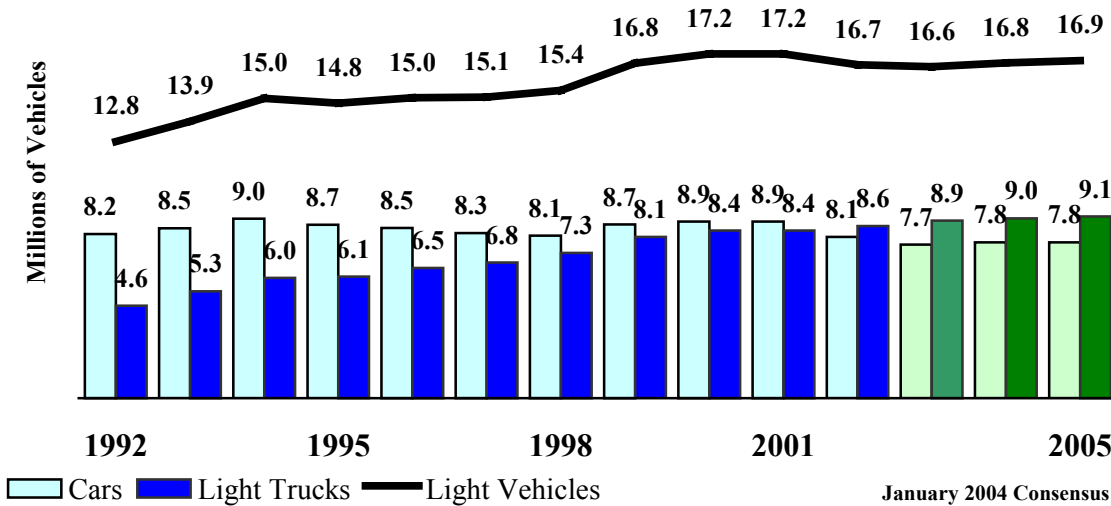
Faster growth in 2004 will be led by stronger business investment growth. Although low capacity utilization rates could restrain investment, the need to replace increasingly obsolete machinery, greater business optimism and higher profits will help accelerate investment. The expiration of bonus depreciation at the end of 2004 and the need to build-up lean inventories will also help boost investment. As automakers (most notably the Big Three) aim to decrease consumer incentives, a strengthening economy will help increase light vehicle sales with projected 2004 sales of 16.8 million units and 16.9 million units in 2005.

Inflation is forecast to remain at low levels. As measured by the consumer price index (CPI), consumer prices are expected to rise 1.9 percent in 2004 and 2.5 percent in 2005. As measured by the consumption deflator, which accounts for changes in the composition of consumption, prices are expected to rise 1.7 percent in 2004 and 2.2 percent in 2005.

Interest rates are projected to increase throughout the forecast horizon but will remain low compared to historical standards. The 90-day Treasury bill is forecast to increase from 1.0 percent in 2003 to 1.5 percent in 2004 and increase to 2.9 percent in 2005 as the economy strengthens. The value of the U.S. dollar is projected to fall in 2004 and 2005.

U.S. employment will increase throughout the forecast horizon. Thus, the U.S. unemployment rate is expected to fall from 6.0 percent in 2003 to 5.6 percent in 2004 and decrease to 5.3 percent in 2005.

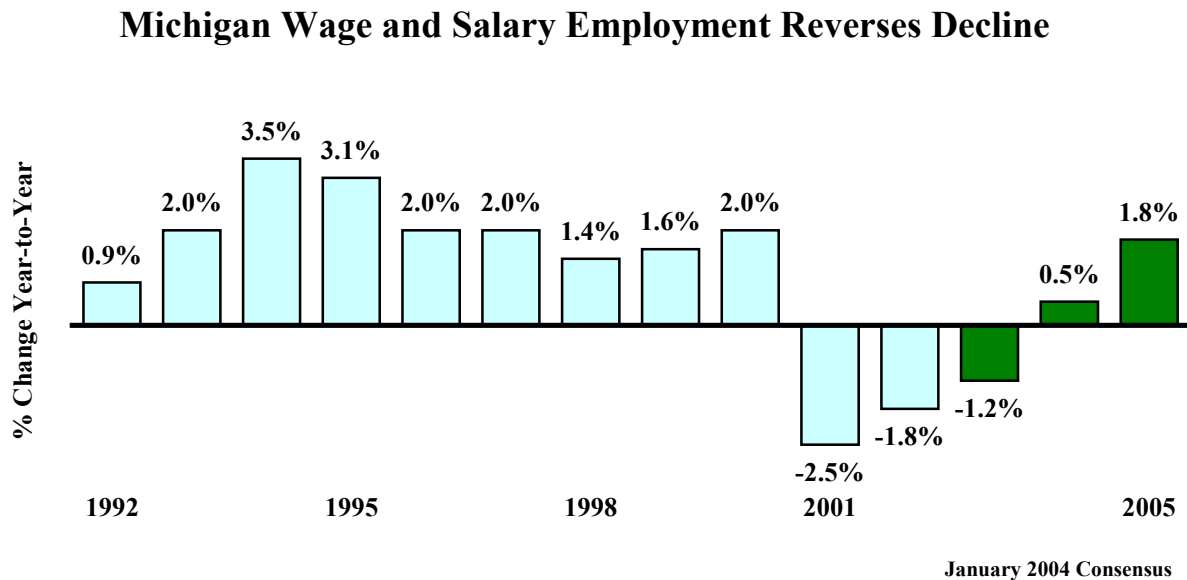
### Light Vehicle Sales Increase Slightly



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Consensus Forecast, January 2004.

## **2004 and 2005 Michigan Economic Outlook**

Michigan wage and salary employment is projected to fall for the third straight year in 2003. In 2004, wage and salary employment is forecast to post slightly positive growth in 2004 (0.5 percent) and then increase at a faster rate of growth in 2005 (1.8 percent). Michigan's unemployment rate is forecast to rise to 7.2 percent in 2004 and then fall to 6.4 percent in 2005.



Source: Michigan Department of Labor and Economic Growth, U.S. Bureau of Labor Statistics and Consensus Forecast.

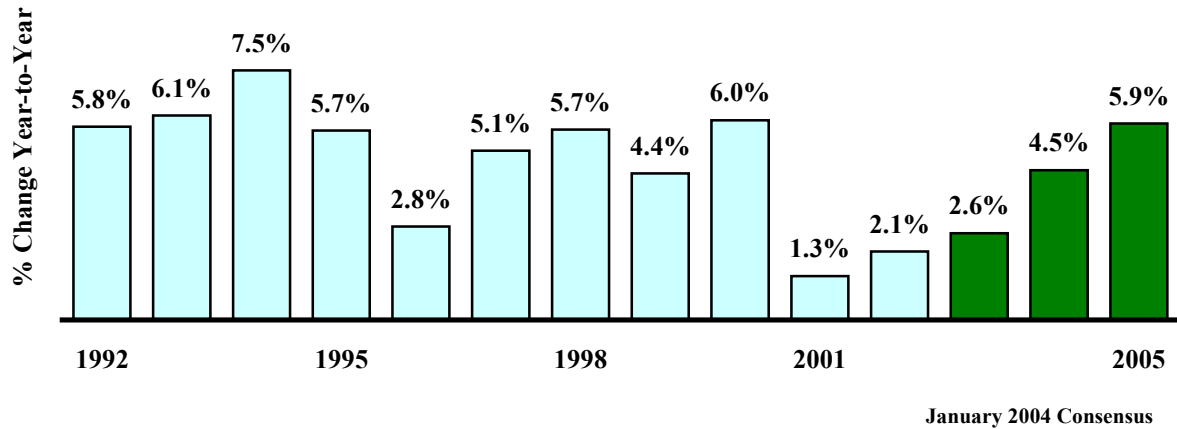
Michigan personal income growth is forecast to increase 4.5 percent in 2004 and rise 5.9 percent in 2005. Wage and salary income is projected to rise by 2.9 percent in 2004 and increase 4.4 percent in 2005.

Inflation, as measured by the Detroit CPI, is forecast to rise 1.9 percent in 2004 and 2.4 percent in 2005. As a result, real Michigan personal income (inflation adjusted) is expected to rise 2.6 percent in 2004 and 3.4 percent in 2005. The Detroit CPI is forecast to rise 1.8 percent in the state fiscal year 2004 and increase 2.3 percent for the state fiscal year 2005.

**Table 1**  
**Consensus Economic Forecast**  
January 2004

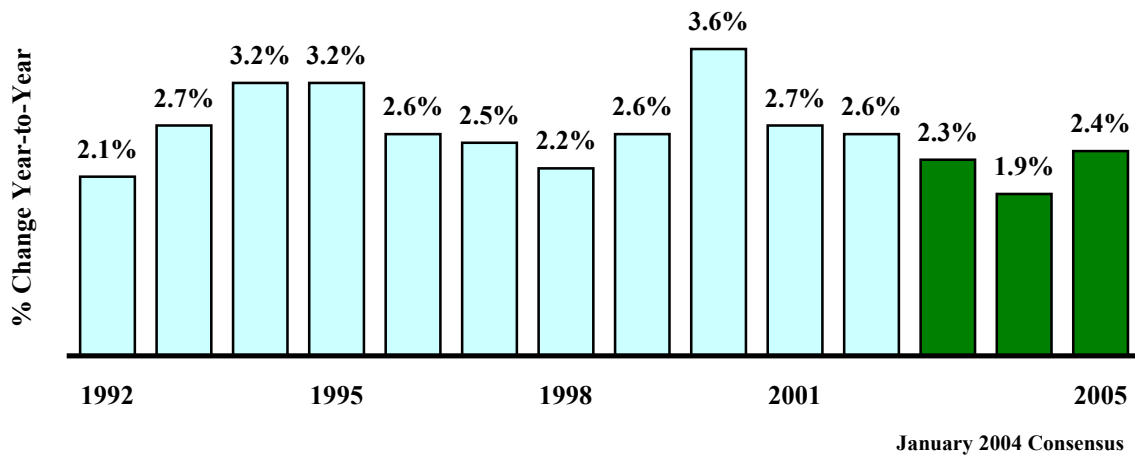
	Calendar 2002 Actual	Calendar 2003 Forecast	Percent Change from Prior Year	Calendar 2004 Forecast	Percent Change from Prior Year	Calendar 2005 Forecast	Percent Change from Prior Year
<b>United States</b>							
Real Gross Domestic Product (Billions of Chained 1996 Dollars)	\$9,440	\$9,731	3.1%	\$10,178	4.6%	\$10,555	3.7%
Implicit Price Deflator GDP (1996 = 100)	110.7	112.4	1.6%	113.9	1.3%	116.1	2.0%
Consumer Price Index (1982-84 = 100)	179.9	184.0	2.3%	187.5	1.9%	192.2	2.5%
Personal Consumption Deflator (1996 = 100)	111.1	113.2	1.9%	115.1	1.7%	117.7	2.2%
3-month Treasury Bills Interest Rate (percent)	1.6	1.0		1.5		2.9	
Aaa Corporate Bonds Interest Rate (percent)	6.5	5.7		5.7		5.8	
Unemployment Rate - Civilian (percent)	5.8	6.0		5.6		5.3	
Light Vehicle Sales (millions of units)	16.7	16.6	-0.6%	16.8	1.2%	16.9	0.6%
Passenger Car Sales (millions of units)	8.1	7.7	-4.7%	7.8	1.3%	7.8	0.0%
Light Truck Sales (millions of units)	8.6	8.9	3.3%	9.0	1.1%	9.1	1.2%
Import Share of Light Vehicles (percent)	19.7	20.2		19.2		19.1	
<b>Michigan</b>							
Wage and Salary Employment (thousands)	4,476	4,424	-1.2%	4,446	0.5%	4,526	1.8%
Unemployment Rate (percent)	6.2	7.1		7.2		6.4	
Personal Income (millions of dollars)	\$303,745	\$311,667	2.6%	\$325,692	4.5%	\$344,908	5.9%
Real Personal Income (millions of 1982-84 dollars)	\$169,785	\$170,296	0.3%	\$174,641	2.6%	\$180,611	3.4%
Wages and Salaries (millions of dollars)	\$173,529	\$175,070	0.9%	\$180,147	2.9%	\$188,253	4.5%
Detroit Consumer Price Index (1982-84 = 100)	178.9	183.0	2.3%	186.5	1.9%	191.0	2.4%
Detroit CPI Fiscal Year (1982-84 = 100)	177.5	182.1	2.6%	185.4	1.8%	189.7	2.3%

## Michigan Personal Income Growth Increasing



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Consensus Forecast, January 2004.

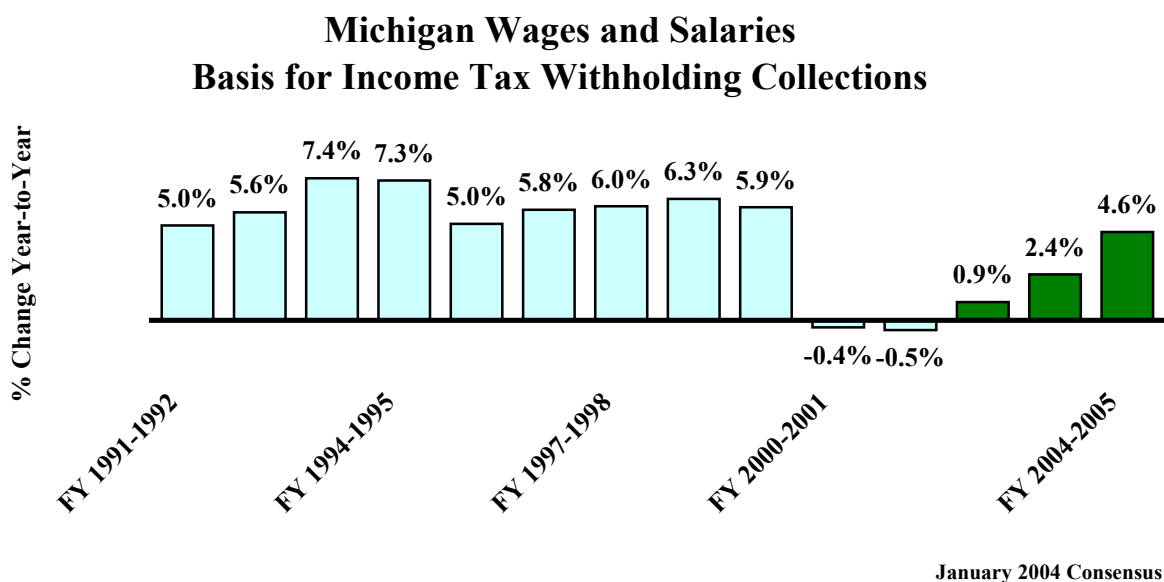
## Inflation Rate Remains Low Detroit CPI



Source: U.S. Bureau of Labor Statistics and Consensus Forecast, January 2004.

## **Fiscal Year Economics**

Michigan's largest taxes are the individual income tax (\$5.8 billion) and sales and use taxes (\$7.7 billion). Income tax withholding is the largest income tax component. Withholding (\$6.5 billion) is most affected by growth in wages and salaries. Michigan wages and salaries are expected to grow 2.4 percent and 4.6 percent in FY 2004 and FY 2005, respectively. These forecasted increases follow three consecutive years of slight declines or slight growth, but are substantially slower than growth reported through much of the 1990s.

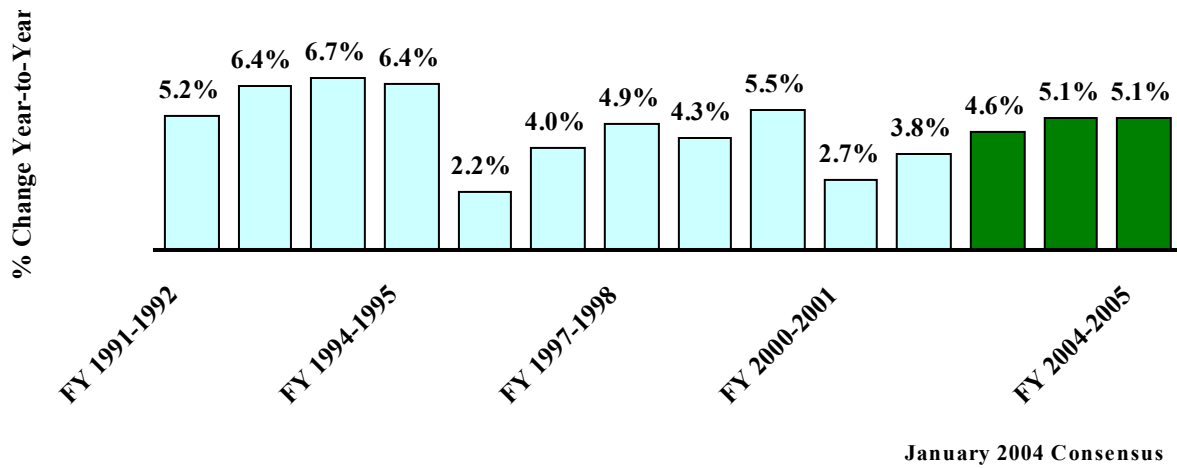


Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Consensus Forecast, January 2004.

Sales and use taxes depend primarily on Michigan disposable (after tax) income and inflation. Disposable income is expected to rise 5.1 percent both in FY 2004 and FY 2005. (See chart on following page.) Disposable income rises faster than wage and salary income because of federal income tax rate cuts. The inflation rate is expected to increase 1.8 percent in FY 2004 and 2.3 percent in FY 2005.



## Michigan Disposable Income Basis for Sales and Use Tax Collections



Source: Research Seminar in Quantitative Economics, University of Michigan and Consensus Forecast, January 2004.

### **Forecast Risks**

The economic outlook is beginning to look positive but uncertainty remains. Two years after the 2001 recession ended, U.S. employment continues to be unable to grow at high levels consistently. Questions remain whether the U.S. labor market can generate employment gains to sustain economic momentum and whether Michigan employment can reverse the trend of declining employment in the near term.

Economic expectations of consumers and businesses grow as reports of strong GDP growth, lower initial unemployment claims, and increasing consumer sentiment are reported in the news. If employment continues to lag and incomes are stagnant, then the possibility exists for expectations not to be met. If consumers and businesses respond to their unrealized economic expectations by decreasing spending and investment, then economic growth may be slower than anticipated.

The baseline forecast predicts that continued and stronger growth will spur U.S. employment increases in 2004 and modest Michigan employment gains by the end of 2004 and into 2005. A continued soft labor market could lower growth below forecasted levels. If business investment increases more than forecast, growth and employment gains could exceed expectations.

If the Big Three automakers continue to steadily lose market share to imports and transplant vehicles, the negative effect on Michigan would be disproportionate compared to other parts of the country.

While the expected lower value of the dollar would help the manufacturing sector and exports, a sharper than expected decrease could lead to instability for U.S. financial markets and increase inflation risks.

## **CONSENSUS REVENUE ESTIMATES**

**January 14, 2004**

### **Revenue Estimate Overview**

The revenue estimates presented in this section consist of baseline revenues, revenue adjustments, and net revenues. Baseline revenues provide an estimate of the effects of the economy on tax revenues. For these estimates, FY 2003 is the base year. Any non-economic changes to the taxes occurring in FY 2004 and FY 2005 are not included in the baseline estimates. Non-economic changes are referred to in the tables as "tax adjustments." The net revenue estimates are the baseline revenues adjusted for revenue adjustments.

This treatment of revenue is best illustrated with an example. Suppose tax revenues are \$10.0 billion in a given year, and that based on the economic forecast, revenues are expected to grow by 5.0 percent per year. Baseline revenue would be \$10.0 billion in Year 1, \$10.5 billion in Year 2, and \$11.0 billion in Year 3. Assume a rate cut is in place that would reduce revenues by \$100 million in Year 1, \$200 million in Year 2, and \$300 million in Year 3. If Year 1 is the base year, the revenue adjustments for Year 1 would be \$0 since the tax cut for this year is included in the base. The revenue adjustments for Year 2 would be \$100 million, and the revenue adjustments for Year 3 would be \$200 million, since the revenue adjustments are compared to the base year.

In the example above, the baseline revenues would be \$10.0 billion, \$10.5 billion, and \$11.0 billion, for Years 1 through 3, respectively. The revenue adjustments would be \$0 in Year 1, \$100 million in Year 2, and \$200 million in Year 3. The \$200 million in Year 3 represents the tax cuts since Year 1. Net revenue would be \$10.0 billion in Year 1, \$10.4 billion in Year 2, and \$10.8 billion in Year 3.

Comparing the Consensus revenue estimates for January to the October Consensus estimates is difficult for two reasons. First, the base year for the estimates has changed from FY 2002 for the October estimates to FY 2003 for the January estimates. Therefore, the January baseline estimates are not comparable to the October baseline estimates.

Second, a number of revenue adjustments that were not included in the October estimates are included in the January estimates. For example, since the October Consensus Conference, the income tax rate cut scheduled for January 2004 has been delayed to July 2004. This will increase the GF-GP revenue estimate for FY 2004 by \$77 million. If the January estimate were compared directly to the October estimate, GF-GP would appear higher due to the rate pause and other tax adjustments. Since the rate pause and other adjustments were included as part of the December budget agreement, the items of interest are how the underlying revenue estimates have changed due to economic factors. Therefore, the October Consensus estimates are adjusted to be on the same basis as the January estimates, so that any differences between October and January are due to economic factors.

## **FY 2003 Revenue Review**

Continued slow economic growth reduced FY 2003 revenues. FY 2003 GF-GP revenue totaled \$7,957.7 million, a 5.6 percent drop from FY 2002. The final FY 2003 GF-GP total was \$49.0 million above the October estimates. The additional revenue was due to non-tax revenues exceeding expectations. FY 2003 SAF revenue totaled \$10,714.7 million, a 5.7 percent increase over FY 2002. The School Aid Fund benefited from a shift in the timing of state education tax payments, which generated approximately \$450 million. School Aid Fund revenues finished \$53.3 million above target primarily due to revenues from the state education tax shift exceeding expectations.

**Table 2**  
**FY 2002-03 Total Revenue**  
(millions)

	<b>Adjusted Consensus October 14, 2003</b>		<b>Actual Consensus Basis</b>		<b>Change</b>
	<b>Amount</b>	<b>Growth</b>	<b>Amount</b>	<b>Growth</b>	
General Fund - General Purpose					
Baseline Revenue			\$7,943.6	NA	
Tax Cut Adjustments			\$14.1	NA	
Net Resources	\$7,908.7	-6.4%	\$7,957.7	-5.6%	\$49.0
School Aid Fund					
Baseline Revenue			\$10,255.6	NA	
Tax Cut Adjustments			\$459.2	NA	
Net Resources	\$10,661.5	5.2%	\$10,714.7	5.7%	\$53.3
Combined					
Baseline Revenue			\$18,199.2	NA	
Tax Cut Adjustments			\$473.3	NA	
Net Resources	\$18,570.2	-0.1%	\$18,672.5	0.6%	\$102.3

Prepared By: Office Of Revenue and Tax Analysis, Michigan Department of Treasury

## **FY 2004 Revenue Outlook**

FY 2004 GF-GP revenue is expected to be \$7,857.5 million, a 1.3 percent GF-GP baseline increase and a 1.3 percent decline after tax cuts. The FY 2004 GF-GP revenue estimate is unchanged from October once the totals are put on a similar base. SAF revenue is forecast to be \$10,584.3 million, a 2.3 percent SAF baseline increase, and a 1.2 percent decline after tax adjustments. (See Table 3.) The FY 2004 SAF revenue estimate is also unchanged from October once the October figures are adjusted to be on a comparable basis.

**Table 3**  
**FY 2003-04 Consensus Revenue Estimates**  
(millions)

	<b>Adjusted Consensus October 14, 2003</b>		<b>Consensus January 14, 2004</b>		<b>Change</b>
	<b>Amount</b>	<b>Growth</b>	<b>Amount</b>	<b>Growth</b>	
General Fund - General Purpose					
Baseline Revenue			\$8,045.5	1.3%	
Tax Cut Adjustments			(\$188.0)	NA	
Net Resources	\$7,857.5	-0.6%	\$7,857.5	-1.3%	\$0.0
School Aid Fund					
Baseline Revenue			\$10,495.4	2.3%	
Tax Cut Adjustments			\$89.0	NA	
Net Resources	\$10,584.3	-1.2%	\$10,584.3	-1.2%	\$0.0
Combined					
Baseline Revenue			\$18,540.9	1.9%	
Tax Cut Adjustments			(\$99.0)	NA	
Net Resources	\$18,441.9	-0.7%	\$18,441.9	-1.2%	(\$0.0)

Prepared By: Office Of Revenue and Tax Analysis, Michigan Department of Treasury

## **FY 2005 Revenue Outlook**

Baseline revenue growth improves in FY 2005 with the improving economy. FY 2005 GF-GP revenue is expected to be \$7,822.8 million, a 4.0 percent baseline increase and a 0.4 percent reduction after tax adjustments. Net GF-GP growth is slowed by a number of factors including the income tax rate cut, the continued phase-out of the state's estate tax, and the shift of some cigarette tax revenues to the Budget Stabilization Fund. SAF revenue is forecast to be \$10,998.5 million, representing 4.0 percent SAF baseline growth and 3.9 percent growth after tax adjustments. (See Table 4.)

**Table 4**  
**FY 2004-05 Consensus Revenue Estimates**  
(millions)

	<b>Consensus January 14, 2004</b>	
	<b>Amount</b>	<b>Growth</b>
General Fund - General Purpose		
Baseline Revenue	\$8,369.3	4.0%
Tax Cut Adjustments	(\$546.6)	NA
Net Resources	\$7,822.8	-0.4%
School Aid Fund		
Baseline Revenue	\$10,917.9	4.0%
Tax Cut Adjustments	\$80.6	NA
Net Resources	\$10,998.5	3.9%
<hr/>		
Combined		
Baseline Revenue	\$19,287.3	4.0%
Tax Cut Adjustments	(\$466.0)	NA
Net Resources	\$18,821.3	2.1%

Prepared By: Office Of Revenue and Tax Analysis, Michigan Department of Treasury

## **Constitutional Revenue Limit**

Article IX, Section 26, of the Michigan Constitution establishes a limit on the amount of revenue State government can collect in any given fiscal year. The revenue limit for a given fiscal year is equal to 9.49 percent of the state's personal income for the calendar year prior to the year in which the fiscal year begins. FY 2002 revenue is compared to CY 2000 personal income. If revenues exceed the limit by less than 1 percent, the state may deposit the excess into the Budget Stabilization Fund (BSF). If the revenues exceed the limit by more than 1 percent, the excess revenue is refunded to taxpayers via the income and single business taxes.

FY 2002 revenues were \$3.9 billion below the revenue limit. State revenues will be well below the limit for FY 2003, FY 2004, and FY 2005 due to the effects of tax cuts and the economic slowdown on the state's revenue stream. FY 2003 revenues are expected to be \$4.4 billion below the revenue limit, FY 2004 revenues are expected to be \$5.1 billion below the limit, and FY 2005 revenues are expected to be \$5.4 billion below the limit. (See Table 5.)

**Table 5**  
**Consensus Constitutional Revenue Limit Calculation**  
(millions)

	<b><u>FY 2002</u></b>	<b><u>FY 2003</u></b>	<b><u>FY 2004</u></b>	<b><u>FY 2005</u></b>
	<b><u>Actual</u></b>	<b><u>Consensus</u></b>	<b><u>Consensus</u></b>	<b><u>Consensus</u></b>
	<b><u>Jan 2003</u></b>	<b><u>Jan 2004</u></b>	<b><u>Jan 2004</u></b>	<b><u>Jan 2004</u></b>
<b>Revenue Subject to Limit</b>	\$23,546.0	\$23,808.2	\$23,769.8	\$24,161.5
<b><u>Revenue Limit</u></b>	<b><u>CY 2000</u></b>	<b><u>CY 2001</u></b>	<b><u>CY 2002</u></b>	<b><u>CY 2003</u></b>
Personal Income	\$289,390	\$297,609	\$303,745	\$311,667
Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	\$27,463.1	\$28,243.1	\$28,825.4	\$29,577.2
<b><u>Amount Under (Over) Limit</u></b>	<b>\$3,917.1</b>	<b>\$4,434.9</b>	<b>\$5,055.6</b>	<b>\$5,415.8</b>

## **Budget Stabilization Fund Calculation**

The Management and Budget Act contains provisions for calculating a recommended deposit or withdrawal from the BSF. The calculation looks at personal income net of transfer payments adjusted for inflation. The change in this figure for the calendar year determines whether a pay-in or pay-out is dictated. If the formula calls for a deposit into the BSF, the deposit is made in the next fiscal year. If the formula calls for a withdrawal, the withdrawal is made during the current fiscal year.

If real personal income grows by more than 2 percent in a given calendar year, the fraction of income growth over 2 percent is multiplied by the current fiscal year's GF-GP revenue to

determine the pay-in for the next fiscal year. If real personal income declines, the percentage deficiency under zero is multiplied by the current fiscal year's GF-GP revenue to determine the withdrawal available for the current fiscal year. If the change in real personal income is between 0 and 2 percent, no pay-in or withdrawal is indicated.

Real calendar year personal income for Michigan is expected to increase by 2.4 percent in 2004, indicating a \$31.4 million pay-in. (See Table 6.)

**Table 6**  
**Budget and Economic Stabilization Fund Calculation**  
**Based on CY 2004 Personal Income Growth**  
**Consensus Calculation**

	CY 2003	CY 2004
Michigan Personal Income	\$ 311,667 <sup>(1)</sup>	\$ 325,692 <sup>(1)</sup>
less Transfer Payments	<u>\$ 50,508 <sup>(1)</sup></u>	<u>\$ 53,538 <sup>(1)</sup></u>
Income Net of Transfers	\$ 261,159	\$ 272,154
Detroit CPI	1.814 <sup>(2)</sup>	1.847 <sup>(3)</sup>
for 12 months ending	(June 2003)	(June 2004)
Real Adjusted Michigan Personal Income	\$ 143,969	\$ 147,377
Change in Real Adjusted Personal Income		2.4%
Excess over 2%		0.4%
GF-GP Revenue Fiscal Year 2003-2004		\$ 7,857.5
		<u>FY 2004-2005</u>
BSF Pay IN for FY 2004-2005		<u>\$ 31.4</u>

Notes:

<sup>(1)</sup> Personal Income and Transfer Payments, Consensus Forecast, January 2004.

<sup>(2)</sup> Detroit Consumer Price Index, Average of 6 monthly values reported by BLS for each 12-month period.

<sup>(3)</sup> Detroit Consumer Price Index, forecast from the January 2004 Consensus Forecast.

## **School Aid Fund Revenue Adjustment Factor**

To assist the Legislature in determining the basic per-pupil foundation allowance for subsequent fiscal years, each Consensus Revenue Estimating Conference calculates a pupil membership factor, a revenue adjustment factor, and an index.

The School Aid Fund (SAF) revenue adjustment factor for the next fiscal year is calculated by dividing the sum of current year and subsequent year SAF revenue by the sum of current year and prior year SAF revenue. For example, the FY 2005 SAF revenue adjustment factor is calculated by dividing the sum of FY 2004 and FY 2005 SAF revenue by the sum of FY 2003 and FY 2004 SAF revenue. The SAF revenue totals are adjusted for any change in the rate and base of the SAF taxes. The year for which the adjustment factor is being calculated is used as the base year for any tax adjustments. For FY 2005, the SAF revenue adjustment factor is calculated to be 1.0317. (See Table 7.)

**Table 7**  
**Consensus School Aid Revenue Adjustment Factor**  
**For Fiscal Year FY 2005**

	<b><u>FY 2002-03</u></b>	<b><u>FY 2003-04</u></b>	<b><u>FY 2004-05</u></b>
Baseline SAF Revenue	\$10,255.6	\$10,495.4	\$10,917.9
Balance Sheet Adjustments	<u>\$459.2</u>	<u>\$89.0</u>	<u>\$80.6</u>
Net SAF Estimates	\$10,714.7	\$10,584.3	\$10,998.5
Adjustments to FY 2005 Base Year	<u>(\$378.6)</u>	<u>(\$8.4)</u>	<u>\$0.0</u>
Baseline Revenue on an FY 2005 Base	\$10,336.2	\$10,575.9	\$10,998.5

### **School Aid Fund Revenue Adjustment Calculation for FY 2004-05**

Sum of FY 2002-03 & FY 2003-04	\$10,336.2	+	\$10,575.9	=	\$20,912.1
Sum of FY 2003-04 & FY 2004-05	\$10,575.9	+	\$10,998.5	=	\$21,574.5

<b>FY 2004-05 Revenue Adjustment Factor</b>	<b>1.0317</b>
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Note: Indexes are calculated off an FY 2005 base year.

The pupil membership factor for the next fiscal year is computed by dividing the estimated pupil membership in the school year ending in the current state fiscal year by the estimated membership for the school year ending in the subsequent fiscal year. The pupil membership factor is 0.9983 for FY 2005. (See Table 8.)



**Table 8**  
**Consensus Estimate of the Pupil Membership Adjustment Factor**

**Consensus Estimates FY 2003-2004**

FY 2003-2004 Pupil Membership	1,642,214	Local District Pupils
	<u>73,786</u>	Public School Academy Pupils
	1,716,000	

**Consensus Estimates FY 2004-2005**

FY 2004-2005 Pupil Membership	1,639,000	Local District Pupils
	<u>80,000</u>	Public School Academy Pupils
	1,719,000	

**FY 2004-2005 Membership Adjustment Factor**

FY 2003-2004 Pupil Membership	<u>1,716,000</u>	=	0.9983
FY 2004-2005 Pupil Membership	1,719,000		

The foundation allowance index is calculated by multiplying the pupil membership factor by the revenue adjustment factor. Therefore, the FY 2005 index is 1.0299. (See Table 9).

**Table 9**  
**Consensus Estimate of the Foundation Allowance Index**  
**Current Law Estimates**

<b>Foundation Allowance Index</b>	<b><u>FY 2004-2005</u></b>
Consensus Pupil Membership Adjustment Factor	0.9983
Consensus Revenue Adjustment Factor	<u>1.0317</u>
Consensus Foundation Allowance Index	1.0299

**Revenue Detail**

The estimated tax and revenue totals include the effects of all enacted tax changes except sales tax savings resulting from reductions in revenue sharing. The revenue totals by tax are presented separately for GF-GP and for the SAF. (See Table 10 and 11.) Tax totals for the income, sales, use, and tobacco taxes for all funds are also included. (See Table 12.)

**Table 10**  
**Consensus General Fund General Purpose Revenue Detail**  
(millions)

	<b>FY 2003</b>		<b>FY 2004</b>		<b>FY 2005</b>	
	<b>Amount</b>	<b>Growth</b>	<b>Amount</b>	<b>Growth</b>	<b>Amount</b>	<b>Growth</b>
<b>GF-GP Tax Amounts</b>						
Income Tax	\$3,961.0	-6.4%	\$3,918.8	-1.1%	\$3,994.1	1.9%
Sales	\$63.6	-27.7%	\$114.2	79.5%	\$119.4	4.6%
Use	\$819.6	-5.6%	\$838.4	2.3%	\$867.8	3.5%
Cigarette	\$289.2	48.4%	\$286.2	-1.0%	\$128.0	-55.3%
Beer & Wine	\$51.1	2.2%	\$51.5	0.8%	\$52.0	1.0%
Liquor Specific	\$31.1	4.0%	\$31.3	0.6%	\$31.6	1.0%
Single Business Tax	\$1,842.9	-7.1%	\$1,878.7	1.9%	\$1,962.5	4.5%
Insurance Co. Premium	\$231.1	1.8%	\$247.0	6.9%	\$261.0	5.7%
Telephone & Telegraph	\$124.2	-9.5%	\$120.6	-2.9%	\$120.6	0.0%
Inheritance Estate	\$98.6	-24.7%	\$70.0	-29.0%	\$34.0	-51.4%
Intangibles	(\$1.4)	0.0%	\$0.0	0.0%	\$0.0	0.0%
Horse Racing	\$0.0	0.0%	\$0.0	0.0%	\$0.0	0.0%
Oil & Gas Severance	\$47.9	56.0%	\$43.0	-10.2%	\$40.0	-7.0%
GF-GP Other Taxes	\$52.6	-58.4%	\$32.0	-39.2%	\$33.0	3.1%
<b>Total GF-GP Taxes</b>	<b>\$7,611.4</b>	<b>-6.0%</b>	<b>\$7,631.7</b>	<b>0.3%</b>	<b>\$7,644.0</b>	<b>0.2%</b>
<b>GF-GP Non-Tax Revenue</b>						
Federal Aid	\$47.2	91.1%	\$30.0	-36.4%	\$30.0	0.0%
From Local Agencies	\$0.9	12.5%	\$1.0	11.1%	\$1.0	0.0%
From Services	\$8.5	63.5%	\$8.0	-5.9%	\$8.0	0.0%
From Licenses & Permits	\$16.9	2.4%	\$18.0	6.5%	\$18.0	0.0%
Miscellaneous	\$98.8	-24.9%	\$60.0	-39.3%	\$62.0	3.3%
Short Term Note Int.	(\$8.0)	0.0%	\$0.0	0.0%	\$0.0	0.0%
Interfund Interest	(\$13.3)	11.8%	(\$50.0)	275.9%	(\$100.0)	100.0%
Liquor Purchase	\$126.8	7.3%	\$120.0	-5.4%	\$121.0	0.8%
Charitable Games	\$11.2	-7.4%	\$11.0	-1.8%	\$11.0	0.0%
Transfer From Escheats	\$57.3	79.6%	\$27.8	-51.5%	\$27.8	0.0%
Other Non Tax	\$0.0	0.0%	\$0.0	0.0%	\$0.0	0.0%
<b>Total Non Tax</b>	<b>\$346.3</b>	<b>5.3%</b>	<b>\$225.8</b>	<b>-34.8%</b>	<b>\$178.8</b>	<b>-20.8%</b>
<b>Total GF-GP Revenue</b>	<b>\$7,957.7</b>	<b>-5.6%</b>	<b>\$7,857.5</b>	<b>-1.3%</b>	<b>\$7,822.8</b>	<b>-0.4%</b>

**Table 11**  
**Consensus School Aid Fund Revenue Detail**

	FY 2003		FY 2004		FY 2005	
	Amount	Growth	Amount	Growth	Amount	Growth
<b>School Aid Fund</b>						
Income Tax	\$1,847.7	-0.7%	\$1,899.6	2.8%	\$1,985.9	4.5%
Sales Tax	\$4,681.4	-0.3%	\$4,824.7	3.1%	\$5,029.2	4.2%
Use Tax	\$410.2	-5.8%	\$419.1	2.2%	\$433.8	3.5%
Liquor Excise Tax	\$30.6	5.2%	\$31.3	2.3%	\$31.6	1.0%
Cigarette	\$471.4	22.1%	\$463.7	-1.6%	\$456.8	-1.5%
Other Tobacco	\$17.7	1.0%	\$16.0	-9.7%	\$16.0	0.0%
State Ed Prop Tax	\$2,127.5	34.3%	\$1,745.2	-18.0%	\$1,858.2	6.5%
Real Estate Transfer	\$275.5	8.9%	\$274.7	-0.3%	\$273.0	-0.6%
Ind and Comm Facilities	\$161.2	5.8%	\$166.0	3.0%	\$167.0	0.6%
Casino (45% of 18%)	\$90.9	0.0%	\$94.5	0.0%	\$97.3	0.0%
Commercial Forest	\$2.8	12.0%	\$2.8	0.0%	\$2.8	0.0%
Other Spec Taxes	\$11.8	0.0%	\$12.0	0.0%	\$12.0	0.0%
<b>Subtotal Taxes</b>	\$10,128.8	6.4%	\$9,949.4	-1.8%	\$10,363.5	4.2%
Lottery Transfer	\$586.0	-4.5%	\$635.0	8.4%	\$635.0	0.0%
<b>Total SAF Revenue</b>	\$10,714.8	5.7%	\$10,584.4	-1.2%	\$10,998.5	3.9%

**Table 12**  
**Consensus Major Tax Totals**

<b>Major Tax Totals (Includes all Funds)</b>						
Income Tax	\$5,810.6	-4.7%	\$5,819.9	0.2%	\$5,981.5	2.8%
Sales Tax	\$6,422.6	-0.2%	\$6,620.7	3.1%	\$6,900.7	4.2%
Use Tax	\$1,229.8	-5.9%	\$1,257.5	2.3%	\$1,301.6	3.5%
Cigarette and Tobacco	\$890.9	37.5%	\$876.8	-1.6%	\$864.1	-1.4%